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Supplemental Budget Takes Shape

Accelerating the supplemental budget process to meet Japan's Persian Gulf commitments, the cabinet of Prime Minister Toshiki Kaifu November 30 approved a FY 1990 supplemental spending package of just under Y2.3 trillion ($17 billion at Y135=$1.00), thus paving the way for Diet action on the spending bill before the end of this year. The Ministry of Finance also is rushing to compile a spending plan for next fiscal year but faces several controversial issues.

The FY 1990 supplemental spending package includes Y627.8 billion ($4.7 billion) for disaster relief and reconstruction and Y459.3 billion ($3.4 billion) for government employee salary hikes. About Y190 billion ($1.4 billion) has been penciled in for Persian Gulf-related measures, including Y130 billion ($963 million) for the multinational military forces in Saudi Arabia; Y20 billion ($148.1 million) in low-interest loans to Egypt, Turkey and Jordan, the countries most affected by the international economic embargo of Iraq and Kuwait; and a Y40 billion ($296.3 million) addition to the government's trade insurance fund to compensate for the increased risk of Middle East transactions. The proposed package also contains Y56.8 billion ($420.7 million) to

political heat has all but disappeared on this issue, the parties remain far apart on how to distribute the burden of the tax more fairly, especially with regard to small businesses, a politically powerful lobby. The prospect of a new property tax also promises to generate political fireworks (see JEI Report No. 45B, November 30, 1990). The LDP's Tax System Research Council November 30 discussed two alternatives for large land holdings: 0.3 percent of the assessed value of property worth more than Y500 million ($3.7 million) or 0.5 percent for real estate valued at Y1 billion ($7.4 million) or more. The tax would become effective April 1, 1992 and be based on annual assessments. Thanks to a large number of exemptions -- for small residential holdings, government-owned land and property used for the public benefit (for example, hospitals) -- the proposed tax would fall on only about 200,000 to 300,000 taxpayers, compared to the approximately 27 million individuals or businesses that currently pay the fixed assets tax. The government will have to overcome strong resistance from corporations with large real estate holdings, however, before enacting such reforms.

Jon Choy

Japanese Firms Struggle With Financial Changes

For some Japanese companies 1990 is the best of times, with profits rising amid the continuing domestic economic expansion, which now is near a postwar record for its duration. But for an increasing number of firms, the worst of times appears close, particularly for companies exposed to the Japanese real estate or stock markets. Itoman & Co., Ltd. exemplifies this group of businesses. A medium-sized trading company traditionally specializing in textiles, the firm is a second-tier member of the Sumitomo keiretsu, although non-Sumitomo firms remain large shareholders and lenders. (For details of Japan's keiretsu, see JEI Report No. 2A, January 12, 1990.) In recent years under the guidance of corporate leaders closely connected to Sumitomo Bank, Ltd., the company increasingly ventured into real estate.

This fall Itoman's problems became apparent. Rising interest rates increased the firm's costs dramatically; a softening real estate market, partly a consequence of the high cost of money, compounded its difficulties. The October 7 resignation of Sumitomo Bank chairman Ichiro Isoda gave Itoman's problems a higher profile even though Mr. Isoda's resignation was said to be unrelated. At the time of his resignation, Itoman already was getting special attention. By mid-November Sumitomo Bank and Itoman appeared to have settled on a rescue plan that called for Itoman to scale back dramatically its debt levels by reducing the level of loans outstanding to smaller, affiliated real estate concerns. The bank also agreed to shoulder some of the debt of one of Itoman's real estate subsidiaries. As of early December, however, Itoman's prospects remained unclear, with new problems surfacing in the press almost daily.

Itoman's rescue, if ultimately successful, will be small potatoes for the Sumitomo Group, which has a reputation for having more than its share of problem companies. The group's most spectacular corporate restructuring was its 1979-80 rescue of Mazda Motor Corp., then known as Toyo Kogyo Co., Ltd. Reportedly on the brink of bankruptcy at that time, the company had recovered fully by the mid-1980s.

The Itoman and Mazda cases seem to suggest that large Japanese companies, unlike their American counterparts, are able to avoid bankruptcy proceedings. Another recent development demonstrates that that impression is not entirely correct. Kyowa Co., Ltd., a steel-processing company, also ventured into the Japanese real estate business, apparently with disastrous results, during the real estate boom of the late 1980s. In late November the company asked the Tokyo District Court for protection under Japan's bankruptcy law so it could proceed with a restructuring plan. In the postwar period many such companies ultimately have emerged from such proceedings as healthy companies, although the process can take years.

With debts of Y200 billion ($1.5 billion at Y135=$1.00) Kyowa is the biggest company to have entered bankruptcy proceedings in 1990 and one of the largest in the postwar period. (The biggest was the 1985 collapse of Sanko Steamship Co., Ltd., which had debts of Y500 billion or about $3.7 billion.) Kyowa is not the only sizable company besides Itoman facing real estate-related problems, however. "Real estate bankruptcy" has joined "labor shortage bankruptcy" as a leading explanation of recent business failures. Those facing real estate-related bankruptcies are often those that, like Itoman and Kyowa, diversified into real estate from other lines of business.

Most Japanese companies facing bankruptcy are small. While bankruptcy cases declined sharply during the 1984-89 period, the trend may have been reversed in late 1990 (see Table). October 1990 saw the first year-to-year upturn since December 1984. The October rate is still far below that of the early to mid-1980s, however.

Corporate Bankruptcies in Japan, 1983-90

(firms with debts of Y10 million or more)

		Number of Cases	Change from Year-Earlier Period	Total Debt (billions of yen)
1983		19,155	11.9%	Y2,584
1984		20,841	8.8	3,644
1985		18,812	-9.7	4,236
1986		17,476	-7.1	3,831
1987		12,655	-27.6	2,122
1988		10,122	-20.0	2,001
1989		7,234	-28.5	1,232
1990	January	455	-24.7	68
	February	448	-25.0	77
	March	502	-36.1	87
	April	526	-22.4	167
	May	501	-24.1	225
	June	516	-18.7	104
	July	482	-12.5	87
	August	514	-8.5	118
	September	531	-6.2	91
	October	646	9.7	150

Source: Tokyo Shoko Research

With labor markets still tightening, interest rates showing no sign of easing significantly and unsold real estate properties multiplying, bankruptcies are likely to increase in coming months, in part because some avenues of escape from financial difficulty have closed. Itoman, for example, has seen the value of its portfolio of stocks decline, reducing the cash it otherwise could raise. In addition, many of its largest holdings are bank stocks, which could be adversely affected by the company's shaky financial position. For the typical large company that plunged into real estate, however, one obvious escape route remains: a renewed emphasis on its core business. Since most industries still show strong profits, such companies probably would find a safe haven. While Itoman's plight would seem to suggest the potential for a viral-like spread of financial difficulty, the overall health of the Japanese economy is likely to prevent such a development.

Douglas Ostrom

Tokyo Supports U.N. Resolution To Use Force Against Iraq

Although not currently a member of the United Nations Security Council, Japan joined its Western allies in supporting the November 29 Security Council resolution authorizing the use of force against Iraq if Baghdad fails to withdraw from Kuwait by January 15, 1991. Prime Minister Toshiki Kaifu, fielding questions from reporters November 30, said that the latest U.N. action will strengthen the effectiveness of the 11 resolutions previously passed by the Security Council condemning Saddam Hussein's August 2 invasion of its oil-rich neighbor. Mr. Kaifu was careful to emphasize, however, that Tokyo's support for a peaceful solution to the Persian Gulf crisis remains unchanged. The Japanese government strongly hopes Iraq will recognize that the resolution represents the definitive view of the international community and will pull out of Kuwait, he said.

Given strong domestic sensitivities to the use of military force, chief cabinet secretary Misoji Sakamoto followed Mr. Kaifu's remarks by reiterating Tokyo's continued commitment to a nonviolent resolution to the Persian Gulf crisis. "Japan will maintain an earnest hope right up to the last moment that the crisis will be settled peacefully," Mr. Sakamoto said. He added that the Japanese government appreciates the Security Council's efforts to resolve the matter in accordance with the U.N. charter, which allows the use of force under certain circumstances.

Since Japan is a signatory to the charter, the peacekeeping organization's approval of the use of force against Iraq should make it somewhat easier for relevant government officials to convince Japanese legislators that Tokyo can and should contribute more than simply money to help resolve this regional conflict, Japanese analysts contend. The 12-2 vote especially relieved those who feared that unilateral military action by the United States would have complicated policymakers' efforts to build support for a more active Japanese approach to this crisis.

Ever since Saddam Hussein's armed forces moved into Kuwait over four months ago, the United States and other allies have urged Tokyo to provide a "visible symbol" of its support for the multinational peace effort (see JEI Report No. 35B, September 14, 1990). A proposal that attempted to respond to

NOTE

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